

National Supply Side of the Energy Market

Energy markets have been roiled by near-record prices across the board, driven by soaring global demand and tight new sources of supply. The demand side of the energy equation is fairly well documented, and closely follows global economic growth. The supply side is less obvious. The response on the supply side to current high prices will be elemental in deciding the future trajectory of these prices. Although the response has been delayed, we believe that new sources of supply are already on their way to the market and will help energy prices moderate over the next few years.

Record-high oil prices have sparked a global search for oil, which will come to fruition in the next few years. The supply side response was especially weak in 2005 due to a number of factors including hurricanes Katrina and Rita in the U.S. We expect new sources of crude, especially from non-OPEC and non-conventional sources, to help plug the gap in the next few years.

The outlook for gasoline and other refined products is more dire. The U.S., and indeed the world, suffers from a refining bottleneck that will take longer to solve. New investment in refining has been limited in the U.S., forcing increased reliance on imports. Apart from the increasing need for new refining capacity, existing refiners will increasingly need to be able to process the heavier, more sour crude coming to the market today.

Natural gas supply in the country is fixed, for the most part, thanks to the weak import infrastructure. High current inventories of natural gas notwithstanding, we will need to develop new



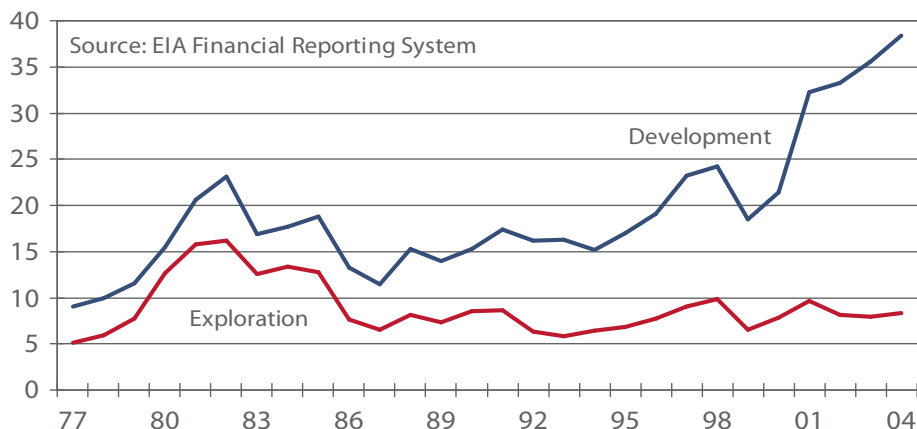
LNG import and re-gasification terminals in the U.S. to meet our increasing demand for natural gas. Much of this capacity is unlikely to come to the market before 2008.

Coal will remain a dependable source of energy in the long term. While not susceptible to geopolitical concerns and natural disasters, coal does have potential bottlenecks, especially the availability of rail transportation. Coal-to-liquid technologies offer small potential to offset imports of crude oil and fuels, but are not seen as a long-term major energy source.

Biofuels are expanding contributions to energy supplies. Under the renewable fuels standard, supplies of products such as ethanol and biodiesel will increase steadily into the next decade. U.S. and global resource endowments will be adequate for expansion of biofuel crops in the medium term, but there are issues to be addressed for long-term expansion. ①

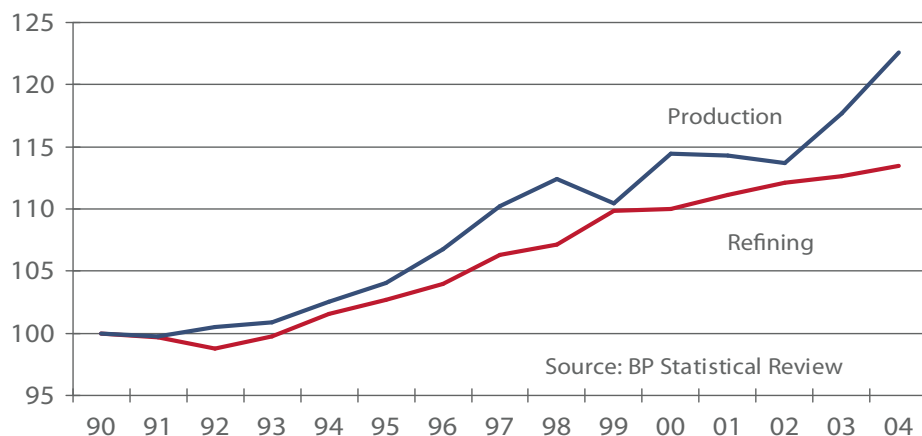
Extracting Oil Is Much More Expensive

Oil company costs, \$bil



Refining Remains the Prime Bottleneck

Relative growth in global capacity, 1990=100



Even As Production Expands, Imports Will Grow

Natural Gas Cubic feet, tril

